



October 28th, 2005

Secretary Alan Lloyd
Agency Secretary
California Environmental Protection Agency
1001 I Street
P.O. Box 2815
Sacramento California
95812-2815

RE: Comments on Proposed California Regional Cap and Trade Program under CAT

Dear Secretary Lloyd:

In October 2005 the Climate Action Team (CAT) issued its latest policy paper titled "Cap and Trade Program Design Options Overview" for discussion with stakeholders. This proposal outlines the possible design considerations under a possible Cap and Trade system that the California government must make decisions on in order to implement its climate change policy. The four main design questions pertain to the (1) Scope of the proposed program, (2) Allowance allocations under any proposed program, (3) Offset considerations, and (4) Other design issues such as environmental justice issues.

Disembarking on a policy discourse of this magnitude requires an appropriate stakeholder consultation and commenting period. In the opinion of IETA, the commenting time period for this particular consultation is simply too short for a meaningful dialogue on the many important elements and details of such a program. As such, through this letter, the International Emissions Trading Association (IETA) is offering the following generic comments on the design of any Cap and Trade program.

At present IETA's membership of over 110 companies is a diverse mix from all segments of the greenhouse gas (GHG) market including many large energy and industrial companies as well as the financial and banking sector, legal firms, brokers, traders, consultants, industry associations, policy institutions, verifiers and certifiers.

The role of IETA is to provide input on design issues relating to greenhouse gas emissions trading by advocating flexibility, openness, and encouraging optimum liquidity. IETA does not take any positions on targets and timetables or support for or against mandatory legislation. As such, our main goal is to facilitate the establishment of efficient liquid emissions trading markets that will help participants to achieve compliance in a cost effective manner.

In June 2005 Governor Schwarzenegger announced an aggressive timetable in California to reduce the state's GHG emissions according to which California will:

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- Reduce emissions to 2000 levels by 2010
- Reduce emissions to 1990 levels, by 2020
- Reduce emissions to 80 % below 1990 levels, by 2050

The CAT has proposed GHG reductions option to ensure stabilization of CO₂ emissions that could be implemented possible through a cap on emissions, with emissions trading of allowances i.e "a Cap & Trade program".

A market approach, including an emission trading system, is one of the tools that can help achieve the goals enunciated above, by promoting price discovery, rewarding innovation, supporting the industrial competitiveness of California and providing incentives for the development of low emission technologies. Designing an effective and efficient emissions trading system is therefore important if California is to balance its climate change commitments with ensuring a healthy economy. Any system that will potentially be designed in California should include the following basic principles: verifiable, credible data; transparency; simplicity; low transaction costs; high liquidity; and fungibility with other systems and mechanisms. In this regard, IETA has several concerns with respect to the California proposal as discussed in following sections.

Scope

The question of scope at this point in the opinion of IETA is a political decision that the California government has to make. IETA would point out that liquidity in a system is a key ingredient to ensuring a viable market approach. A multiple sector approach will result in increased market liquidity and lower costs of compliance for industry, as compared to a proposal that covers a single greenhouse gas, and / or a single emitting sector.

The primary selection criteria for including any given sector in a greenhouse gas reduction effort should include such factors as the sector's relative contribution to state greenhouse gas emissions, the ability to develop accurate estimates of sector emissions and reductions, and the means to accurately measure and verify emissions in the sector. To avoid overly burdensome costs, there must be a realistic threshold whereby small emissions installations (within a sector) can be excluded. The scope of the program should be based on a sector approach, which helps create a level playing field for the included sectors.

Offsets

Any proposed Cap & Trade program under the CAT proposal should ensure removal of any or all restrictions on GHG trading. All gases should count and all project types (forestry, methane capture, etc.) should be included without limits. This will ensure:

- Greater market liquidity
- Improvement in cost-effectiveness of the program ensuring that many of the lowest cost reductions are not excluded or restricted



- Increased realization of overall net social and environmental benefits

Any proposed cap & trade program should also not have any numerical or geographical source limits/caps on entity-wide emissions trading from international trades, sequestration, or non-covered entity offsets. Any artificial limits or caps could potentially limit the amount of cost-effective offsets generated and traded significantly. From a market perspective CAT should learn from the sub optimal experiences of the CDM Executive Board when engaging with the development of protocols and methodologies. It would best serve the purposes of a simple and transparent process if the method of approaching this exercise would not be on a project-to-project basis.

Allocations

The CAT group in considering design options should ensure that any proposed cap and trade program is not potentially seen to promote significant auctions as a mechanism. Auctions will increase company and customer costs/risks substantially, and will have the potential to distort the trading markets. If auctions were to be considered an option, IETA would urge to make them for minor amounts, (i.e 5 - 10 %) of any total allocation, mainly for two reasons.

First, auctions will result in a major redistribution of funds through a new government bureaucracy, reducing market efficiency and reducing funds available for companies that need to make the reductions. Secondly, auctions will increase direct costs and risks for those most affected by the regulations. This will result in higher overall costs and reduce market efficiency. IETA recommends that any allocation of allowances should be done through benchmarking or grandfathering, rather than auctioning and redistribution. This will mitigate customer impacts better than a government redistributive program.

Concluding Comments

IETA believes if CAT broadens the scope of trading to include more sectors, all greenhouse gases and to have unrestricted offsets, the costs will be reduced very significantly. This in turn will result in increased social integrity of any proposed system as well as addressing environment integrity issues such as any 'leakage' problem. Also, we believe that allowances should be largely allocated to the companies that are incurring the costs to reduce their emissions and as such, view that a much smaller set aside is in order.

In conclusion, IETA is encouraged that California is considering a "Cap and Trade" emissions trading program as one of the potential policy tools to meet its climate change commitments. Our experience from the EU ETS and Canadian markets indicates that a successful program requires a thoughtful, thorough and rigorous design process. Accordingly, our recommendations are intended to leverage these learnings for a California process that will be low cost as well ensure environmental and social integrity



within systems. Importantly, IETA believes that the California GHG market may not adequately materialize under the CAT Proposal since the scope is too narrow, which means most of the benefits of emissions trading will not be realized.

We hope our comments will prove helpful and provide an insight into the policy concerns and challenges that IETA would be pleased to address together with CAT as well as California EPA in the coming months.

Yours truly,

A handwritten signature in black ink, appearing to read "Andrei Marcu", is positioned above the typed name.

Andrei Marcu
President and CEO
International Emissions Trading Association